Internal Revenue Service

memorandum

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date: DEC 14 1989

to: Assistant District Counsel, Washington, DC MA:WAS
Attn: Diane Helfgott

from: Assistant Chief Counsel (Tax Litigation) CC:TL

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subject: Wage Payments Made by Employers to Illegal Aliens

This memorandum is in response to your request for technical advice in connection with a proposal by the Baltimore District to audit employers convicted of hiring illegal aliens. Your request has been coordinated with the office of the Assistant Chief Counsel (Employee Benefits and Exempt Organizations) and they concur with our analysis and conclusions.

ISSUES

Whether wages to illegal aliens are deductible business expenses. Whether employment taxes should have been withheld on those wages and if so, whether they were deductible business expenses.

CONCLUSION

It is the position of this office that both the wages paid to the illegal aliens and the employment taxes paid over to the government are deductible as ordinary and necessary business expenses under I.R.C § 162.

FACTS

The issues in question have arisen in connection with news stories concerning the conviction of certain employers for hiring illegal aliens. The employers have been identified as owners of fast food franchises, as well as other businesses. They were convicted under 8 U.S.C. § 1324a which penalizes the hiring of aliens for employment in the United States knowing that such aliens are unauthorized with respect to such employment. The district is interested in disallowing deductions presumably claimed for the wages paid to these illegal aliens. Such wages would normally be deductible as ordinary and necessary business expenses under I.R.C. § 162. However, the district wishes to challenge these deductions on the basis that these wage payments constitute illegal payments under I.R.C. § 162(c)(2).

DISCUSSION

Section 162(c)(2) denies a deduction for any payments which constitute an illegal bribe, illegal kickback, or other illegal payment under any law of the United States, or under any law of a State, which subjects the payor to a criminal penalty or the loss of license or privilege to engage in a trade or business. It is important to note that the Commissioner has the burden of establishing that the payments in question are illegal, or subject the payor to a criminal penalty or loss of license or privilege, under federal or generally enforced state law.

After studying 8 U.S.C. § 1324a, it appears that the sole purpose of the statute was to make it unlawful for any person or other entity to hire, recruit or refer for a fee for employment in the United States an unauthorized alien. As you have pointed out, there is no indication either in the statute itself or in the legislative history that Congress also intended for the wages paid to these unauthorized aliens to be illegal.

Section 162(c)(2) was drafted very narrowly and very specifically. The Commissioner must establish that the deductions we disallow are, in fact, contrary to a law of the United States or of an individual state. There is nothing in section 162(c)(2) or 8 U.S.C. § 1324a which indicates that the payment of wages to unauthorized aliens is an illegal payment. We firmly believe that these wages are ordinary and necessary business deductions for the employer. If Congress had intended for the accompanying wage payments to unauthorized aliens to be illegal they would included such a provision in the law. We see no reason for denying these deductions on the basis that they are anything other than ordinary and necessary business expenses.[1] As you note in your request, both § 162(c)(2) and the legislative history accompanying the statute indicate that the payment itself must be illegal, as opposed to a legitimate payment made in furtherance of an illegal activity.

Support can also be found in Carter v. Commissioner, T.C. Memo. 1984-443, where the Court held that wages paid to employees engaged to smuggle drugs into the United States from Colombia did not constitute illegal payments and were deductible expenses under section 162, although the activity was clearly illegal. The Court did not distinguish between gross wages and net wages; therefore, in our opinion, the gross wages, which include the

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[1] An example of where Congress has acted in such a situation is found in I.R.C. § 280E. Here, Congress has denied deductions or credits for any amount paid or incurred in carrying on the trade or business of trafficking in controlled substances. Prior to this time such deductions and credits were allowed as business expenses.

federal income tax withheld as well as the employee share of FICA, would be deductible.

Sections 3121(a), 3306(b) and 3401(a) define wages, for purposes of FICA, FUTA, and federal income tax withholding respectively, as all remuneration for employment.

Section 3121(b) defines employment as any service, of whatever nature, performed by an employee for the person employing him, irrespective of the citizenship or residence of either. Section 3306(a) defines employer as any person who, during any calendar quarter, paid wages of $1,500 or more, or on each of some 20 days during the calendar year or during the preceding calendar year, each day being in a different calendar week, employed at least one individual in employment for some portion of the day. Section 3401(d) defines employer as the person for whom an individual performs or performed any service as the employee of such person. There is no exception from federal employment taxes and income tax withholding for services performed by an illegal alien.

Revenue Ruling 60-77, 1960-1 C.B. 387 held that any individual engaged in an illegal activity is subject to the same laws and regulations, in determining whether he is an employee, as individuals engaged in legal activities. An individual is considered to be an employee for federal tax purposes, whether the activity is legal or illegal, if, under the usual common law rules, an employment relationship exists between the parties.

Revenue Ruling 77-140, 1970-1 C.B. 301 concerns services performed for farmers in the United States by aliens who entered the country illegally. While the services performed by aliens who enter the country legally are excepted from employment for purposes of FICA under section 3121(b)(1), Revenue Ruling 77-140 held that because the aliens were not legally admitted to the country, the services they performed were not excepted from employment.

Accordingly, in applying the law and the principles set forth in the revenue rulings, we conclude that the wages paid to illegal alien employees are subject to federal employment taxes and federal income tax withholding on wages at the source. We also concur with your conclusion that there would be no basis for disallowance of the employer's share to the extent it would qualify as a trade or business expense under section 162(a).

CONCLUSION

It is the position of this office that the wages paid to the unauthorized aliens as well as the employment taxes which have been withheld and paid over to the government, are deductible as ordinary and necessary business expenses. For further assistance please contact Steven W. Ianacone at FTS 566-3407.

MARLENE GROSS

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